



**INDEPENDENT COMMUNITY  
BANKERS of AMERICA**

February 13, 2012

Jennifer J. Johnson, Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, D.C. 20551

Robert E. Feldman, Executive Secretary  
Attention: Comments  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street, NW  
Washington, D.C. 20429

Office of the Comptroller of the Currency  
250 E Street, SW  
Washington, D.C. 20219

Re: Re: Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds: Docket ID OCC-2011-14; Fed Docket No. R-1432 and RIN 7100 AD 82; FDIC RIN 3064-AD85

Dear Sir and Madam:

The Independent Community Bankers of America<sup>1</sup> (ICBA) welcomes the opportunity to comment on the banking agencies' proposed rule that would implement Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), sometimes referred to as the Volcker Rule. The proposed rule contains certain prohibitions and restrictions on the ability of a banking entity and nonbank financial company supervised by the Federal Reserve Board to engage in proprietary trading and have certain interests in, or relationships with, a hedge fund or private equity fund.

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<sup>1</sup> The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever changing marketplace.

With nearly 5,000 members, representing more than 20,000 locations nationwide and employing nearly 300,000 Americans, ICBA members hold \$1 trillion in assets, \$800 billion in deposits, and \$700 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at [www.icba.org](http://www.icba.org).

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## ICBA's General Comments on the Volcker Rule

**ICBA generally supports the Volcker Rule which is an important step toward protecting the fundamental business of banking from the speculation inherent in proprietary trading and sponsoring or investing in hedge funds or private equity funds.** Banks are accorded access to federal deposit insurance and liquidity facilities because they serve a public purpose: facilitating economic growth by intermediating between savers and borrowers, *i.e.*, taking deposits and making loans, and by maintaining liquidity in the economy throughout the economic cycle. These activities constitute the fundamental business of banking.

In contrast, proprietary trading and certain hedge fund and private equity fund activities are conducted for the sole purpose of generating profits for the bank's owners and are not related to the entity's banking activities or to providing services to customers. As a result, banks engaged in these activities face numerous conflicts of interest. The enormous profits possible in proprietary trading and hedge fund and private equity fund activities entice financial institutions and make it likely they will underestimate the associated risks. The recent financial crisis and the ensuing government bailout show what happens when banks depart from the fundamental business of banking. The Volcker Rule prohibits conflicts of interest and ensures that government subsidies like federal deposit insurance and liquidity facilities will not fund, even indirectly, speculative trading by banks and their affiliates. **There should not be a federal safety net for proprietary trading or investing in or sponsoring hedge funds and private equity funds.**

Part of what makes proprietary trading and sponsoring or investing in hedge funds and private equity funds excessively risky is their ever-increasing complexity. These activities are so complex that it is difficult even for financial managers to fully understand the nature or extent of the associated risks. Unable to fully appreciate the risk, managers cannot properly mitigate or hedge those risks. If the managers themselves cannot fully understand the risks, it is even less likely that the market, investors, or regulators will be able to take the precautions needed to protect safety and soundness at individual institutions and the larger U.S. financial system. The Volcker Rule recognizes the complexities involved by prohibiting banks from engaging in these activities and requires the regulators to impose additional capital and diversification requirements on nonbank financial institutions engaged in the limited trading and investment activities that are permitted under the Volcker Rule.

## ICBA's Comments on the Interagency Proposal

The interagency proposal takes a multi-faceted and comprehensive approach to implementing the Volcker Rule. In particular, the proposed rule includes a framework that (1) describes the key characteristics of both prohibited and permitted activities, (2) requires banking entities to establish a comprehensive "programmatic" compliance regime designed to ensure compliance with the requirements of the statute and rule, and (3) with respect to proprietary trading, requires certain banking entities to calculate and

report quantitative data that will assist the banking agencies in identifying particular activity that warrants additional scrutiny to distinguish prohibited proprietary trading from otherwise permissible activities. **In formulating the proposed rule, ICBA commends the banking agencies for taking into consideration the potential impact of the proposed rule on small banking entities that engage in little or no covered trading activities or covered fund activities and investments.**

**Definition of Proprietary Trading:** The proposal largely restates the statutory definition of “proprietary trading,” defining that term to mean engaging in the purchase or sale of one or more covered financial positions as principal for the trading account of the banking entity. The proposal goes on to define the term “trading account” as any account used for acquiring or taking positions in securities principally for the purpose of selling in the near term. The banking agencies note that it is often difficult to clearly identify the purpose for which a position is acquired or taken and whether that purpose is short-term in nature, particularly since identification of that purpose generally depends on the intent with which the position is acquired or taken. However, often the intent can be discerned from the actions of the bank.

**ICBA commends the banking agencies for excluding repurchase and reverse repurchase arrangements from the proposed rule’s definition of trading account as long as under such arrangements, the banking entity has simultaneously agreed, in writing at the start of the transaction, to both purchase and sell a stated asset, at stated prices and on stated dates or on demand with the same counterparty.** For many community banks, these arrangements are an important way for making investments on a short term basis. We agree that such positions held under a repurchase or reverse repurchase agreement operate in economic substance as a secured loan, and are not based on expected or anticipated movements in asset prices. Furthermore, including them into the definition of “trading account” would inhibit community banks from using this important investment tool.

Also, in defining the term “trading account,” regulators should ensure that the authority of insured state banks to make certain investments under Section 24 of the Federal Deposit Insurance Act is preserved.<sup>2</sup> Enacted in 1991 as part of Congress’s response to the savings and loan crisis, Section 24 generally requires insured state banks to limit their investments to those that are permissible for a national bank. Subsection (f) of Section 24, however, specifically permits certain insured state banks to make limited investments in equity securities that would not otherwise be permissible. Subsection (f) was adopted to preserve the authority of some state banks, primarily mutual savings banks in New England, to make equity investments. These powers date back to the 19th century, and the institutions exercising them do so under well-established state and federal guidelines.<sup>3</sup>

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<sup>2</sup> 12 U.S.C. § 1831a.

<sup>3</sup> See, e.g., 12 C.F.R. § 362.3, 18(g)(3); ME. REV. STAT. ANN. tit. 9-B, § 419; MASS. GEN. LAWS ch. 167F § 3; N.H. REV. STAT. ANN. §§ 387:1-18. The first mutual savings banks in the United States were organized in 1816, and the popularity of the mutual savings banks grew through the beginning of the 20th century. FDIC Division of Research and Statistics, *History of the Eighties—Lessons for the Future*, vol. 1, *An Examination of the Banking Crises of the 1980s and Early 1990s* 211-212 (Dec. 1997). These banks were known for their “conservative management, and this was reflected in most state laws governing savings banks.” *Id.* at 212. Since those early days, state law has “specified the types of investments permitted[, including investments in blue chip common and preferred stocks]; set ceilings on the percentage of assets

For many years, qualifying banks have used their subsection (f) investment powers prudently, and no one has suggested that these powers contributed to the recent financial crisis.

In promulgating regulations to implement subsection (f), the Federal Deposit Insurance Corporation recognized that Congress intended to create a specific, focused exemption, noting that “the legislative history of section 24(f) reveals an intent by the drafters to create an exception for banks that had invested in listed common and preferred stock and registered shares . . . [and] nothing beyond those types of securities.”<sup>4</sup> ICBA is not aware of any suggestion that Congress intended the Volcker Rule’s general prohibitions to apply to the specific investment powers of certain banks under subsection (f). If Congress meant to eliminate the Section 24(f) powers it could have repealed or revised Section 24(f) when passing the Dodd-Frank Act.

The Volcker Rule was not drafted to target the narrow investment powers specified under subsection (f), and community banks exercising these powers did not contribute to the financial crisis. **ICBA recommends that the definition of “trading account” specifically exempt securities that are traded pursuant to subsection 24(f) investment powers, so it is clear that those powers are preserved, and community banks that exercise those powers will not be violating the proposed rule.**

**Risk-Mitigating Hedging Activities:** The proposed rule permits a banking entity to purchase or sell a covered financial position if the transaction is made in connection with, and related to, individual or aggregated positions, contracts, or other holdings of a banking entity and is designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings.

Unfortunately, the banking agencies have proposed a complex set of criteria that must be met in order for a banking entity to rely on the hedging exemption, including setting up an internal compliance program and a set of written procedures consistent with subpart D of the proposal.

Although we agree that banks that participate in extensive risk-mitigating activities should have in place a sophisticated compliance program and internal control procedures that includes independent testing, **the regulations should make clear that community banks that engage from time to time in interest rate swaps to hedge their interest rate risk should be able to do so without complying with subpart D of the proposal and without having to comply with any of the proposed criteria to prove that their risk-mitigation activities are not proprietary trading. We recommend that that banks with consolidated assets of \$10 billion or less be able to participate in interest rate swaps without having to comply with any of the proposed criteria under the risk-mitigating hedging activity exemption (including compliance with subpart D) as long as aggregate exposures for such swaps do not exceed 10% of a community bank’s tier one capital.** Community banks would then be able to continue their present practice of using interest rate swaps without having to worry about adopting extensive new compliance procedures and without having to prove to an examiner that the bank is engaging in a permitted activity under the Volcker Rule.

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or deposits permitted in each type; and laid out detailed criteria for evaluating eligibility.” *Id.*

<sup>4</sup> 57 Fed. Reg. 53211, 53227 (Nov. 9, 1992).

**Permitted Trading on Behalf of Customers:** ICBA agrees that there should be an exemption from the prohibition on proprietary trading to allow banks to purchase or sell a covered financial position on behalf of customers. Under the proposed rule, the purchase or sale of a covered financial position is on behalf of customers if the transaction (1) is conducted by a banking entity acting as investment adviser, commodity trading advisor, trustee, or in a similar fiduciary capacity for a customer and for the account of that customer, and (2) involves solely covered financial positions of which the banking entity's customer is the beneficial owner. We agree that this category will capture a wide range of trading activity, including activities engaged in by community banks, conducted in the context of customer-driven investment, trust or fiduciary services. These activities should be exempt as long as they are structured a way that the customer, and not the banking entity providing these services, benefits from any gains and suffers any losses on such covered financial position.

**Permitted Trading in Government Obligations:** ICBA also commends the agencies for proposing a broad exemption that would allow trading in government securities. This broad exemption would permit the purchase or sale of a covered financial position that is (1) an obligation of the United States or any agency thereof, (2) an obligation, participation, or other instrument of or issued by the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation, or a Farm Credit System institution; or (3) an obligation issued by any State or any political subdivision thereof. The proposal rule also clarifies that these obligations include limited as well as general obligations of the relevant government entity, as well as participations and other instruments issued by such entities.

While most community banks do not participate in “proprietary trading” of government obligations (i.e., buying and selling of government obligations for short term gain), they do occasionally purchase and sell government obligations on a short term basis. A broad unconditional exemption will allow them to continue to invest in government obligations without having to be concerned with violating the Volcker Rule or without the concern that they may be under some presumption of violating the Volcker Rule which they would have to overcome with documentation and procedures. We also believe the exemption is also sufficiently clear and that the agencies do not need to broaden the scope of the exemption.

**Reporting and Recordkeeping Requirements:** ICBA also commends the agencies for their tiered approach to reporting and recordkeeping requirements. Under the proposal, a banking entity must comply with the proposed Appendix A's extensive reporting and recordkeeping requirements only if it has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which is, as measured as of the last day of each of the four prior calendar quarter, equal to or greater than \$1 billion. Although few community banks would ever come close to that threshold, we agree with the agencies that they should not extend the reporting and recordkeeping requirements to banking entities with smaller amounts of trading activity, since the more limited benefits of applying these requirements to such banking entities, whose trading activities are



typically small, less complex, and easier to supervise, would not justify the burden associated with complying with the reporting and recordkeeping requirements. The proposed \$1 billion trading asset and liability threshold is currently used in the Market Risk Capital Rules for purposes of identifying which banks and bank holding companies must comply with those rules, and is an appropriate standard for triggering the reporting and recordkeeping requirements.

**Compliance Program Mandate:** The proposed rule also adopts a tiered approach to implementing the compliance program mandate, requiring only banking entities that have significant covered trading activities or covered fund activities to adopt a compliance program that meet certain minimum standards. However, the proposed rule goes on to state that even if a banking entity does not engage in covered trading activities and covered funds activities and investments, “it must ensure that its existing compliance policies and procedures include measures that are designed to prevent the banking entity from becoming engaged in such activities and making such investments.” In other words, every banking institution, even if it does not engage in such activities, would need some kind of program to monitor compliance with the proposed rule to ensure that the rule is never violated.

**Requiring every bank to amend its compliance policies and procedures and set up a monitoring program, even if it does not engage in covered trading activities or covered fund investments, is not only unnecessary, but a costly, inefficient way to ensure compliance with the Volcker Rule.** A community bank that is not engaged in covered trading activities or covered fund activities and investments should not have to amend all its compliance policies and procedures just to prove that it is aware of the Volcker Rule prohibitions and the requirement for a compliance program. If the proposed rule is adopted, ICBA is concerned that community bankers will be forced into hiring “Volcker Rule” specialists to amend their policies and procedures and to demonstrate to its examiners that it is not violating the rule. If the intent of the rule is to make sure that every compliance specialist is aware of the Volcker Rule prohibitions and its requirement for a compliance policy, a better and less costly approach would be to educate bankers on the Volcker Rule prohibitions by conducting outreach meetings, teleconferences, banker education courses, and issuing regulatory guidance.

## Conclusion

ICBA generally supports the Volcker Rule which is an important step toward protecting the business of banking from the speculation inherent in proprietary trading and sponsoring or investing in hedge funds or private equity funds. Banks are accorded access to federal deposit insurance and liquidity facilities and the Volcker Rule prohibits conflicts of interest and ensures that government subsidies like federal deposit insurance and liquidity facilities will not fund, even indirectly, speculative trading by banks and their affiliates. There should not be a federal safety net for proprietary trading or investing in or sponsoring hedge funds and private equity funds.

With regard to the definition of proprietary trading, ICBA commends the banking agencies for excluding repurchase and reverse repurchase arrangements from the proposed rule's definition of trading account. However, in defining the term "trading account," regulators should ensure that the authority of insured state banks to make certain investments under Section 24(f) of the Federal Deposit Insurance Act is preserved.

Although we agree that banks that participate in extensive risk-mitigating activities should have in place a sophisticated compliance program and internal control procedures, we think the regulations should make clear that community banks that engage from time to time in interest rate swaps to hedge their interest rate risk should be able to do so without complying with subpart D of the proposal and without having to comply with any of the proposed criteria to prove that their risk-mitigation activities are not proprietary trading. We recommend that the proposed rule be amended so that banks with consolidated assets of \$10 billion or less would be able to participate in interest rate swaps without having to comply with any of the proposed criteria under the risk-mitigating hedging activity exemption as long as aggregate exposures for such swaps do not exceed 10% of a community bank's tier one capital.

ICBA agrees that there should be an exemption from the prohibition on proprietary trading to allow banks to purchase or sell a covered financial position on behalf of customers and we commend the agencies for proposing a broad exemption that would allow trading in government securities. While most community banks do not participate in "proprietary trading" of government securities, they do occasionally purchase and sell government obligations on a short term basis. A broad unconditional exemption will allow them to continue to invest in government obligations without having to be concerned with violating the Volcker Rule.

ICBA agrees that only banks with trading assets and liabilities equal to or greater than \$1 billion should be subject to the recordkeeping and reporting requirements of the proposed rule. However, requiring every bank to amend its compliance policies and procedures and set up a monitoring program, even if it does not engage in covered trading activities or covered fund investments, to ensure compliance with the Volcker Rule is expensive and unnecessary. A community bank that is not engaged in covered trading activities or covered fund activities and investments should not have to amend all its compliance policies and procedures just to prove that it is aware of the Volcker Rule prohibitions and the requirement for a compliance program.

ICBA appreciates the opportunity to comment on the banking agencies' proposed rule to implement the Volcker Rule. If you have any questions about our letter, please do not hesitate to contact me at 202-659-8111 or [Chris.Cole@icba.org](mailto:Chris.Cole@icba.org).

Sincerely,  
/s/ Christopher Cole

Christopher Cole  
Senior Vice President and Senior Regulatory Counsel